Environmental Insurance and Brownfields Redevelopment

Indiana Brownfields Conference
April 11-12, Indianapolis, Indiana

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Presentation Overview

"More than you ever wanted to know about environmental insurance for brownfields, but were smart enough <u>not</u> to ask!"

Presentation Overview

- The background, logic and purposes of different environmental insurance **(EI)** products
- How local governments might use EI for their brownfield projects
- Why developers don’t often use EI
- Recent changes in the environmental insurance market

FOUR (count'em - 4!!) <u>DISSERTATIONS!!</u>

…. The first two topics emerge from over a decade of research and technical assistance addressing environmental insurance for EPA and HUD …

…. The second two derive from a series of specific targeted research projects.

I’ll Talk Fast

You Listen Fast …

… and ask questions as fast as you can

1. EI – The Background

Product Lines Relevant to Brownfields:

- ✓Pollution Liability
- ✓Cost Cap
- ✓ Pre-Funded Programs
- ✓ Secured Lender or Creditor
- ✓ Other insurance products you might hear about

Pollution Liability - 1/2

- Most widely used and oldest EI product
- For the consequences of past pollution on a site and its possible migration off-site:
  - Third Party coverage for cleanup costs, bodily injury, and property damage, whether Third Party is new site user or property's neighbors
  - Legal Defense against Third Party Claims
  - First Party claims for cleanup of new pollution conditions discovered on the site
- Highly "manuscripted" with extremely complex endorsements and modifications

Pollution Liability - 2/2

- $1-100 Million in Coverage available
- $25 - 250,000 Deductible is the norm
- Terms of 1-10 Years, longer terms cost a lot more per year
- Premiums range $40 – 250,000, depending on term, coverage and the details of the manuscripted policy conditions
- No meaningful cost/$1 M can be reported

Cost Cap or Stop Loss – 1/2

- Intended to limit the possible costs of site remediation or pollution containment
- Based on site assessment, engineering, and the cost of a cleanup plan
- Not a substitute for due diligence work
- Not available or cost-effective for projects with expected cleanups of under $1-2 M
- Requires a deductible or “self-insured retention” – 10-30% of cleanup plan costs

Cost Cap or Stop Loss – 2/2

- May involve a co-payment on overruns
- Coverage maximum of 2 X (cleanup cost)
- Premium of 6–25% of cleanup plan costs
- Term available: 1-5 years, bought for the time the cleanup is expected to take
- The insurance behind Guaranteed Fixed Price Remediation (GFPR) contractors that offer a fixed price to complete an agreed-upon level of cleanup at a site.
- GFPR contractors have become the major users of Cost Cap

Pre-Funded Programs

- Involve up-front payment of the anticipated site expenses where a cleanup is planned.
- Requires detailed remediation plans
- Insurer invests funds, takes on timing, investment, and cost-overrun risks
- Insured/Insurer share remaining funds if money is left over after the work gets done
- For cleanups of $5-60 M, expected to be done 5-20 years in the future
- May include Pollution Liability coverage

Secured Lender Coverages

- Cover lenders’ losses from pollution conditions arising on collateral properties
- Generally pay the lesser of the estimated cleanup costs or outstanding loan balance
- Coverage may vary if claim is made before or after bank foreclosure
- Policy terms are generally 3-10 years
- Single site, 5-year policy will get $3 -10 million in coverage limits, with premiums of $45,000 - 70,000; and deductibles of $10,000 -100,000

Other Coverages / Products

- Environmental Services Industry Products
  - Professional consultants' "E & O" coverages
  - Contractors' pollution liability coverages
  - Environmental surety performance bonds
- "Owner Controlled" policies can cover gaps in individual contractors' manuscripted policies and offer PL coverages for all parties involved with a brownfield project
- Land Use Control Policy for RBCA'ed sites
  - Stop loss and professional liability coverages
  - ***Failure of Controls*** coverage
  - ***Maintenance and Enforcement of Controls***

Whew!!

Overview is Over WITH!!

Questions? - Issues?

2. Governments and EI

- Local Governments have been using EI to bring sites to market and to bring capital to projects
- State Governments are examining if EI complements or is a substitute for other brownfield incentives
- Efficient use of EI as a development tool requires that its strengths, limits, and fits with other sorts of incentives are understood

State Consideration of EI

- Many States have already started to look at EI as a tool … **including Indiana**!!
- The others include … Idaho, Delaware, Ohio, Oregon, Vermont, Rhode Island, Virginia, Wyoming and New Jersey
- Three States have EI Programs …
  Massachusetts, Wisconsin and New York
- One, California, has a program on hold
- Three are developing new programs
  Colorado, Wisconsin and Pennsylvania

Existing State Programs – 1/2

Massachusetts’ *MassBRAC* – “Brownfields Redevelopment Access to Capital”

- Started 1999; run by MassBusiness
- Subsidizes CC, and PL coverages
- Has ‘mortgagee/insured assignment’ as SL
- Negotiated “standard coverages” with insurer to simplify, but developers add many endorsements
- Paid over $5 M premium subsidies ($12 M total) for $1 B of coverage limits for some 275 projects,
- Reports over 26,000 jobs created and over $2.4 Billion in investments leveraged, 1999-late 2005

Existing State Programs – 2/2

Wisconsin Voluntary Party Liability Exemption (VPLE) Insurance Program

- From 2001, covering the state agency
- To allow closure offers to developers using natural attenuation before process is completed
- portfolio policy: aggregate limit of $10 M with site sub-limits of $1 M and a 10 year term

New York Environmental Insurance Tax Credit

- Credit of lesser of $30,000 or 50% of premiums
- Requires a Brownfield Cleanup Agreement with NY
- For year in which Certificate of Completion is issued by state’s DEC
- Started 4/1/2005 for calendar year taxpayers

California – On Hold

Financial Assurance and Insurance for Redevelopment (FAIR) Program

- Modeled on MassBRAC
- Development initiated and led by California Environmental Protection Agency (Cal/EPA)
- Funds for subsidies authorized by legislation
- Money currently unavailable, program on indefinite hold

Pennsylvania – Look Out!!

… proposed program is based on California's -- initial effort in 2003, problems with multiple insurer requirements; ongoing negotiations in 2005

Wisconsin’s New Thrust

Brownfield Insurance Program (WBIP)

- Pre-negotiated PL policy at a discounted price
- Available to participants in the state’s VCP
- insurer selected, contract expected in 2006

Noteworthy Development Process

- Led by Dept. of Natural Resources, with external multi-stakeholder Brownfields Working Group
- DNR selected broker, based on RFQ process
- Broker negotiated to get coverage state wanted
- Insurers offered competitive bids to provide coverage; revised bids on DNR, broker requests
- Cost to DNR to date: staff time; broker working for anticipated commissions

Colorado's Information Hotline

Conducted Insurance Needs Assessment

- State got outside help to host workshops on information and insurance needs
- Found primary need was CC for small sites
- Discovered lack of knowledge about EI
- State did not have resources to subsidize cost

Developing Insurance Information Hotline

- Basic data on insurance types, coverages, costs and uses for brownfield redevelopment projects
- Question line for users to post queries
- Pre-qualified volunteer brokers, underwriters to answer questions and maybe gain new business

Local Government EI Use

Problems

- The small number of qualified EI brokers and underwriters still find the public sector slow and indecisive, compared to private developers
- Requirements for multiple bids and public review run counter to the proprietary practices built into the process of manuscripting specific coverages
- Using RFPs for insurance, not RFQs for brokerage services, means public buyers remain ill-informed

Prospects

- Risk reduction may be more cost-effective than cash subsidies in attracting developers' interest
- Public sector-led redevelopment efforts can use insurance directly, often paid for by sellers

Brownfield Subsidy Options

For Private-Led Projects

- Cash Subsidies to raise returns on investment
  - Direct monetary subsidies & property value writedowns
  - Tax abatements, holidays and credits for costs
- Measures to reduce project risk, and thus the demand for “risk adjusted” (higher) returns
  - Indemnifications (drawing on sovereign immunity?)
  - Insurance coverages and risk transfers

For Public-Led Projects

- Seller incentives to gain access to properties
  - Prospective liability relief with acceptance of RBCA
  - Cost cap protections to get PRPs to actually mitigate
- User incentives to attract investor interest
  - Protection from Third Party lawsuits on RBCA sites

Case Studies of Local EI Efforts

Three cases examined

- "Masked" so honest answers won't damage peoples' careers if they admit to mistakes
- Diverse, to make sure we have cases involving different local development and/or pollution issues and varying local government capacities
- Tracked over time, since projects change and the risk perceptions of stakeholders shift over time as development plans are formulated

The big lesson learned:

Major delays blamed on local governments were actually caused by private companies – buyers, sellers, brokers, builders, and others

… But those were not the Insurance Lessons

- Insurance can smooth the adversarial nature of a brownfields (real estate) deal
- Better information reduces uncertainty, so it can reduce both need and cost for insurance
- Time has political and monetary costs, but the savings in risk control expense from the added data collection may be worth far more
- Expertise – even if kept on retainer – is worth the cost to match up to private sector experts
- Insurance is not a panacea, and may be a waste of money for some projects

Some Questions to Ask of <u>Any</u> Insurance Policy

- ✓ Are the risks of concern adequately covered, both in monetary and policy term limits?
- ✓ Have extraneous coverages not needed to for the transaction been excluded?
- ✓ Are the appropriate parties protected as needed? Are they comfortable with their risk exposures?
- ✓ Is the overall coverage price, including the premium, deductible or self-insured retention, and co-pay requirement, acceptable to all of the parties involved?

Whew!!

STRETCH TIME!!!

Questions? - Issues?

3. Developers Reject EI !!

- Not all of the them, and not all the time
- Risk perception and acceptance varies
- Some risks just can’t get coverage
- Risk management does not require an insurance policy, just due care
- Legal shields also help developers – but may be a problem for municipalities

2001-2002 Survey Results

(Thanks to Lincoln Institute of Land Policy)

- Brownfields are real estate deals
  - 56% - project had above average ROI
  - 25% - project had “exceptional ROI
  - 90% - these returns are what made it a “GO”
- Over 45% of Developers cited factors like
  - subsidies for assessment and/or mitigation
  - low interest loans, tax breaks
- Environmental Insurance ???
  - mentioned by only 44% of developers
- Bank financing?
  - used by 63% of the projects

Did They Buy Insurance?

- Only 11% of developers bought **Cost Cap**
  - Due in part to cleanups costing under $1 million
- Biggest risk concern was ***cleanup of previously unknown onsite pollution***
  - But more intensive site assessment was seen as the lower cost way to control the risk
- 22% bought **Pollution Liability**
- But 40% using RBCA and Institutional Controls bought PL

EI is not bought for Projects – but to protect careers & firms

Impact	**Importance Ascribed to Insurance (% rating as)**	
	not important	**important or very important**
On Staff Reputations		
insignificant/troublesome	76	24
very serious/catastrophic	33	67
On Firm's Financials		
insignificant/troublesome	93	7
very serious/catastrophic	36	64

2003-04 Forced Choice Survey

(Thanks, EPA for $$s; ULI for developers)

- Avoid “strategic response, choosing the answers based on the policy you want
- Make respondents pick between bundles of incentives – they can’t have them all
- Provide a common scenario for choices:
  - residential project, townhouses to rent
  - total development cost of $25 million
    - $6 Million purchase price
    - $1 Million for site assessment, remedial response
    - 18 Million demolition and construction
  - $30 million in present value of revenue stream
  - Return on Investment (ROI) of 20 %

Valuations of Risks Avoided

Assurance of	$ Value	% Cost	% Profit
avoiding a public hearing	**$212,000**	0.9 %	4.7 %
eliminating all cleanup cost risk*	**$702,000**	3.1 %	15.6 %
eliminating 3rd party liability risk*	**$969,000**	4.1 %	21.5 %

* liability protection provided upon state approval of completed environmental response

Effects of Developer Experience

Incentive	$ Value	As Percentage of Project	As Percentage of Profits
Avoiding a Public Hearing			
All Respondents	$ 211,543	0.9%	4.7%
Brownfield Specialists	**$ 129,303**	0.6	2.9
Non-specialists	**$ 237,348**	1.1	5.3
Eliminating all Cleanup Cost Risk			
All Respondents	$ 701,776	3.1%	15.6%
Brownfield Specialists	$ 681,228	3.0	15.1
Non-specialists	$ 726,887	3.2	16.2
Eliminating Third Party Liability Risk			
All Respondents	$ 968,817	4.1%	21.5%
Brownfield Specialists	**$ 648,894**	2.9	14.4
Non-specialists	**$1,081,261**	4.8	24.0

What we've Learned

- Developers can manage risks without EI
  - Some tools (LLCs) are not good for the public
  - Others (detailed site assessments) are good
- Property Owners may want PL to protect them from future risk exposures
- More developer experience generates:
  - Greater risk acceptance
  - Less interest in insurance
- Brownfield redevelopment's future is bright

Whew!!

Good news!

Let’s Quit!

(but are we really ahead???)

Questions? - Issues?

4. Recent EI Trends

Changes, 1999-2005, Include

- ✓ **Carrier Turnover** … only 4 have lasted
- ✓ **Pollution Liability** Coverage…
  - ✓ Premiums => UP (by 62% or more, constant $s)
  - ✓ Available term => DOWN (to 10 years, max)
- ✓ **Cost Cap / Stop Loss** Coverage …
  - ✓ Less available – too many carriers lost money
  - ✓ Premiums are UP – a lot
  - ✓ Conditions, Participation requirements are UP
  - ✓ Uninsurable “Small” Cleanups now up to $1 M+

More Trends and Changes

- ✓ **Secured Lender** Coverage …
  - ✓ Not available in place of site assessments
  - ✓ Policy Term is DOWN (to 10 yrs, max, not 15)
  - ✓ One 1 Underwriter covering portfolios
  - ✓ Payment for “lesser of,” not “loan balance”
- ✓ **Guaranteed Fixed Price Remediations**
  - ✓ Appear to be the growing “thing”
  - ✓ Insurers like them: engineering contractors do the investigations and cost share in overruns
  - ✓ Increasingly include PL as well as CC, so offer security to sellers as well as redevelopers
  - ✓ May be transferable to new occupants,owners

Looking to the Future

- Further Insurance Market Tightening?
  - – YES: Katrina and Rite … and 2006 will hit
  - – YES: more competing placements for capital
- Expanding Demand for PL Coverage?
  - – YES: FAB 143 and FIN 47 will force sales
  - – NO: Major Industrial Landowners say that 10 year terms are useless to them
- New forms of Pre-Funded Programs?
  - – Yes, for RBCA Long Term Stewardship
  - – Yes, to address FIN 47-generated demands

Whew!!!

...Oops!

Resources On-Line

- **EPA’s Environmental Insurance Page**

<http://www.epa.gov/brownfields/insurebf.htm

- **CEPM’s Practice Guide Collection**

<http://cepm.louisville.edu/publications/publications.htm>